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In the Supreme Court of the United States

OCTOBER TERM, 1941.

Nos. .... and .....

THE GLIDDEN COMPANY
and
UNITED STATES GUARANTEE COMPANY,
Petitioners,

vs.

THE UNITED STATES OF AMERICA.

(Two Actions, Nos. 8652 and 8653, in the Circuit Court and Nos. 18,119 and 18,145 in the District Court.)

PETITIONS FOR WRITS OF CERTIORARI
To the United States Circuit Court of Appeals
For the Sixth Circuit.

The above named petitioners pray that writs of certiorari issue to review the judgments of the United States Circuit Court of Appeals for the Sixth Circuit, entered in the above cases on April 18, 1941, reversing judgments of the United States District Court for the Northern District of Ohio, Eastern Division. Applications for rehearing were duly filed on May 17, 1941, and on June 25, 1941, were denied by said Circuit Court.

OPINIONS BELOW.

The opinion of the District Court filed September 25, 1938 (R. 62),[1] its opinion filed December 13, 1938 (R. 68), and its opinion filed September 22, 1939 (R. 76), are unreported.

The opinion of the Circuit Court of Appeals (R. 86) is reported in 119 F. (2d) 235.

JURISDICTION.

The applications for rehearing were denied by the Circuit Court of Appeals on June 25, 1941. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED.

(1) Whether the $6.40-per-proof-gallon penalty ("tax") under Section 900 of the Revenue Act of 1926 (44 Stat. 9; 26 U. S. C. A. Section 245) is the *exclusive* measure of recovery under a permit bond, upon the principal's diversion of denatured alcohol to beverage purposes.

(2) Whether there can be any recovery against either principal or surety upon a surety bond to protect the revenue, after it has been adjudicated that the principal is not liable for any taxes or penalties by reason of the identical acts alleged as breaches of the bond.

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[1] Since the pleadings in both cases are substantially alike, and the cases were treated as one, references are to the record in Case No. 18,145, unless otherwise stated.

STATUTE INVOLVED.

Revenue Act of 1926, c. 27, 44 Stat. 9:

Tax on Distilled Spirits

SEC. 900. Subdivision (a) of section 600 of the Revenue Act of 1918, as amended, is amended to read as follows:

"SEC. 600. (a) There shall be levied and collected on all distilled spirits now in bond or that have been or that may be hereafter produced in or imported into the United States, in lieu of the internal-revenue taxes now imposed thereon by law, an internal-revenue tax at the following rates, to be paid by the distiller or importer when withdrawn, and collected under the provisions of existing law.

"(1) Until January 1, 1927, $2.20 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon; and

"(2) On and after January 1, 1927, and until January 1, 1928, $1.65 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon; and

"(3) On and after January 1, 1928, $1.10 on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon.

"(4) On and after the enactment of the Revenue Act of 1926, on all distilled spirits which are diverted to beverage purposes or for use in the manufacture or production of any article used or intended for use as a beverage there shall be levied and collected a tax of $6.40 on each proof gallon or wine gallon when below proof, and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the person responsible for such diversion. If a tax at the rate of $2.20, $1.65 or $1.10 per proof or wine gallon has been paid upon such distilled spirits a credit of the tax so paid shall be allowed in computing the tax imposed by this paragraph. (U. S. C. A., Title 26, Section 245.)"

STATEMENT.

The two actions are brought upon three bonds given in support of permits issued to The Glidden Company for the withdrawal and use of denatured alcohol in the manufacture of non-beverage products, the material condition of which was as follows:

> "Said principal * * * shall pay for all such denatured alcohol illegally or unlawfully diverted, lost, or unaccounted for in violation of such permit and law and regulations at the rate of $4.50 per wine gallon, and *in addition thereto,* shall pay all *penalties* and fines imposed." (R. 12.)

Though the bonds containing the above condition were given on March 7, 1927, July 20, 1927, and January 19, 1928, respectively, their *form* had been adopted prior to the enactment, in 1926, of the above-quoted statute when, through Congressional oversight, there was a gap in the taxing statute such that a diverter of tax-free alcohol for beverage purposes (not a distiller or importer) was not liable for *any* tax or diversion penalty, and would have escaped scot-free, except for the $4.50-per-wine-gallon stipulation in the permit bond, quoted above.

Despite the plugging of this legislative loophole by the above-quoted Revenue Act of 1926, imposing a penalty (so-called "fax") at the rate of $6.40 per proof gallon (approximately $12.80 per wine gallon) upon the person responsible for the diversion of alcohol for beverage purposes, the old form of bond was continued in use.

The petitions in these actions allege (R. 8 to 29) that between November 6, 1927, and February 1, 1930, The Glidden Company diverted to beverage purposes certain tax-free denatured alcohol withdrawn under permits supported by said bonds, by selling non-beverage products manufactured from such denatured alcohol to persons who, to the alleged knowledge of said principal, intended to "clean" said products and use the alcoholic content for beverage purposes.

The answers (R. 47-61) deny the essential allegations of the petitions, and set forth several affirmative defenses, of which only two will be here considered.

The Second Defense (R. 47-53) is that the bonds are indemnity bonds, to secure the revenue, under which (upon diversion to beverage purposes) only the *actual damages* can be recovered, consisting of such revenues (taxes or penalties) as are collectible (upon diversion) from the principal (consisting here of the $6.40 diversion penalties); and that it was adjudicated in a prior action (*United States v. Glidden,* 78 F. (2d) 639, cert. den. 296 U. S. 652) that, subsequent to the alleged diversions, the principal was exonerated from said penalties by its conviction and fine on a plea of *nolo contendere* and by various other extrinsic circumstances.

The Fourth Defense (R. 53), was that the Commissioner of Internal Revenue was not empowered to exact a bond doing more than indemnifying the government against loss of revenue, consisting of such taxes and penalties as might be payable by the principal (*United States v. Zerbey,* 271 U. S. 332), and was not empowered to impose by a stipulation in the bond, *in addition* to the $6.40-per-proof-gallon diversion penalties imposed by Congress, additional penalties at the rate of $4.50 per wine gallon; and that the bond, though otherwise constituting a valid contract, is therefore unenforceable to the extent of the additional $4.50 penalty imposed by the terms of the bond itself "beyond the requisitions of the statute." (*United States v. Tingey,* 9 U. S. (5 Peters 115, 131) 248.)

After the District Court overruled the government's demurrers to the affirmative defenses the government filed replies (R. 70-74). The District Court thereupon granted defendants' motions for judgments on the pleadings, upon the ground that the replies did not present any substantial issue of fact.

The Circuit Court of Appeals has reversed the judgments and directed a trial upon the merits.

SPECIFICATIONS OF ERROR TO BE URGED.

The Circuit Court of Appeals erred:

1. In upholding as valid a stipulation for the payment of $4.50 per wine gallon *in addition* to the actual damages consisting of the $6.40-per-proof-gallon statutory beverage-diversion penalties.

2. In failing to uphold the dismissal of the actions on the ground that the only revenue recoverable under the bonds as actual damages were the $6.40 statutory penalties from which the principal had been exonerated by the judgment in the prior action, *United States v. Glidden, supra.*

3. In reversing the judgments of the District Court.

REASONS FOR GRANTING THE WRIT.

1. Assuming that the bonds, though of an obsolete and no-longer-appropriate form at the time they were given, were valid contracts, and that, if the principal diverted the alcohol, it became liable, as actual damages, for the *penalties* which were expressly made payable in such event. Those were the exceedingly stiff diversion penalties (so-called "tax") imposed by the 1926 Act at the rate of $6.40 per proof gallon (nearly $12.80 per wine gallon).

But those diversion penalties constituted the *only* revenue recoverable from a non-distiller diverter, and constituted the "*actual damages,*" and the *only* damages, recoverable under the bonds. The bonds are bonds of *indemnity* (not penal bonds) under which *only* the actual damages are recoverable, consisting of those revenues (taxes or penalties) for which the principal would be liable even if there were no bond. (*United States v. Zerbey, supra.*)

United States v. Bornn, 104 F. (2d) 641 (C. C. A. 2d) cert. den. 308 U. S. 606, upheld a recovery, under a similar bond, at the stipulated $4.50-per-wine-gallon rate, because in that case the bond was written and breached *prior* to the

1926 Act, when (by legislative inadvertence) there was *no other liability* upon the diverter except that imposed by the bond itself.

But after the 1926 amendment imposed the $6.40 penalties upon the diverter, the provision for the payment of $4.50 *in addition* to the statutory penalties (expressly payable) was not only obsolete but void and unenforceable.

This Court held in *United States v. Tingey, supra,* that a bond exacted by an official of the government as a condition of engaging in a lawful business or occupation is an involuntary bond, and that conditions therein "beyond the requisitions of the statute" are void and unenforceable.

The purpose of the bonds in suit was to *protect the revenue,* by furnishing surety for the payment, by the principal, of the revenues (here the $6.40 statutory penalties) for which, upon diversion, the principal became liable. The provision in the then-obsolete form of bond for the payment of $4.50 per wine gallon *in addition* to the recoverable revenues (actual damages) was "beyond the requisitions of the statute." The Commissioner went beyond "protecting the revenue" when he attempted to impose a $4.50-per-wine-gallon penalty *on top* of the $6.40-per-proof-gallon penalties imposed by the statute.

The Circuit Court's judgment is therefore in head-on conflict with this Court's holdings in *United States v. Tingey* and *United States v. Zerbey, supra.*

2. From the only recoverable revenues (penalties) for which the principal became liable, if it breached the bond, it has been adjudicated to have been exonerated by subsequent events. (*United States v. Glidden, supra.*)

The government sought by the prior action to recover from the principal all the taxes and penalties for which the principal was alleged to have become liable under Section 900 of the Revenue Act of 1926 by reason of the identical acts alleged in the present actions as breaches of the bonds.

(See the government's petition to this Court in said prior action for a writ of certiorari (pages 5 and 6) and its reply brief (pages 1 and 3).) The prior action was dismissed, and the judgment therein conclusively adjudicated that the principal was not liable either for the penalties or for the basic distiller's tax which the statute merges in the penalty rate.

If the government were to sue the Glidden Company now for the basic distiller's tax otherwise than on these bonds, said prior judgment would be a complete defense and bar. These actions on the bonds may be different causes of action from the prior action cited, but insofar as these actions attempt to use the basic distiller's tax as a measure of damages and liability they attempt to enforce a liability and measure of damages from which the principal defendant has been exonerated.

Under the principle of *United States v. Zerbey, supra,* the bonds are bonds of indemnity, to protect the revenue, and to furnish assurance (surety) of the payment of those revenues (taxes or penalties) for which the *principal* becomes liable by reason of the acts constituting the alleged breaches of the bonds.

The bond itself adds nothing to the liability and creates no liability. It merely furnishes *surety* for the collection of the revenues (here the $6.40 diversion penalties) for which, upon beverage diversion, the *principal* becomes liable.

Since the principal has been exonerated by the prior judgment, there can be no recovery on the bonds. (*Jenkins v. City,* 79 Ill. App. 339.) A surety is not liable upon such an indemnity bond for a liability to which its principal has a complete defense with respect to the alleged measure of damages.

The Circuit Court, therefore, failed to apply correctly the law of *res judicata,* and its judgment *is in conflict* with the very decisions of this Court which are cited in the opinion of the court below on this subject.

CONCLUSION WITH RESPECT TO REASONS FOR THE WRIT.

These are the first of the numerous "alcohol bond cases," which have been or are pending, to reach this Court that involve bonds given under the Revenue Act of 1926 and seek (1) to enforce a penalty (sometimes called "liquidated damages") superimposed by a government official upon penalties fixed by the Congress or (2) to collect the basic distiller's tax as the measure of damages after the principal had been adjudicated in a prior action not to be liable for the penalties into which the Congress merged such distiller's tax.

While these cases have not been tried on their merits, there are no merits to try since the records show complete defenses as a matter of law. In such circumstances both parties and the lower courts should be saved from long futile trials.

Citizens and governmental officers alike should be advised whether governmental officers may add to penalties prescribed by the Congress for the very type of alleged violation of law which is covered by the statute. And the repose and good order of society requires an end to litigation when the liability is once adjudicated.

Respectfully submitted,

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